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SHAREHOLDERS' REMEDIES FOR VIOLATION OF PROXY RULE 14a-9

by Mark S. Werbner

The corporate proxy has risen to a powerful position in the world of corporate management. Although the proxy was not recognized at common law,¹ solicitation of proxies through a proxy statement is now the principal device through which corporate management obtains the stockholders' votes.² Congress enacted section 14(a) of the Securities Exchange Act of 1934³ in order to promote full disclosure and "the free exercise of the voting rights of stockholders."⁴ By this statute a large number of corporate proxies came under federal regulation.⁵ Section 14(a) makes unlawful the use of the mail or any instrumentality of interstate commerce or any national securities exchange for the solicitation of any proxy in contravention of any rule or regulation promulgated by the Securities Exchange Commission (SEC).⁶ Pursuant to this rulemaking authority, the Commission promulgated rule 14a-9 which provides:

No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy . . . written or oral, containing any statement which, at the time . . . it is made, is false or misleading with respect to any material fact . . . necessary in order to make the statements therein not false or misleading.⁷

The Securities Exchange Act of 1934 granted the SEC the authority to enforce the Act and its regulations.⁸ All proxy statements within the Act's scope must be filed with the Commission before the stockholders' meeting

1. *McKee v. Home Sav. & Trust Co.*, 122 Iowa 731, 98 N.W. 609 (1904); *State v. Board of Directors*, 60 Nev. 382, 110 P.2d 212 (1941); *Axe, Corporate Proxies*, 41 MICH. L. REV. 38 (1942).

2. Professor Loss has commented:

The widespread distribution of corporate securities, with the concomitant separation of ownership and management, puts the entire concept of the stockholders' meeting at the mercy of the proxy instrument. This makes the corporate proxy a tremendous force for good or evil in our economic scheme. Unregulated, it is an open invitation to self-perpetuation and irresponsibility of management. Properly circumscribed, it may well turn out to be the salvation of the modern corporate system.

2 L. LOSS, SECURITIES REGULATION 857-58 (1961) (citations omitted).

3. 15 U.S.C. § 78n(a) (1970).

4. The congressional rationale for enacting § 14(a) was that "[f]air corporate suffrage is an important right that should attach to every security bought on a public exchange." H.R. REP. NO. 1383, 73d Cong., 2d Sess. 13 (1934). The provision was designed to insure "that proxies would be solicited with explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought." *Id.* at 14. See also *Klaus v. Hi-Shear Corp.*, 528 F.2d 225, 232 (9th Cir. 1975), discussing the congressional intent behind § 14(a).

5. It was in part due to the large number of proxy statements being examined annually which led to the Court's holding in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), that a private cause of action existed under § 14(a). The Court stated that "[t]he Commission advises that it examines over 2,000 proxy statements annually and each of them must necessarily be expedited. Time does not permit an independent examination of the facts set out in the proxy material" *Id.* at 432.

6. 15 U.S.C. § 78n(a) (1970).

7. SEC Rule 14a-9, 17 C.F.R. § 240.14a-9 (1977).

8. Securities Exchange Act of 1934, § 21, 15 U.S.C. § 78u (1970).

for which they are to be effective.⁹ The Commission's acceptance, however, is in no way a concession that the proxy statement is in conformance with the rules.¹⁰

In the heat of a proxy contest the minority faction's request to the SEC for action is often ineffective.¹¹ In 1964 the Supreme Court recognized a private right of action in the shareholder for violation of rule 14a-9 in addition to the Commission's enforcement powers.¹² Increasingly, dissident shareholders have carried the proxy contest into the federal court system.¹³ Such an action may arise in several different contexts. One common setting is a corporate merger proposed by the directors.¹⁴ Litigation may arise before the shareholders' meeting if a shareholder or a class of shareholders seeks to block the meeting and the vote on the merger by charging that the proxy instrument is false or misleading with respect to a material fact. Occasionally, however, actions are not initiated until after the merger has been consummated.¹⁵ The aggrieved shareholder of the merged corporation then takes legal action complaining that the proxy statement was in violation of rule 14a-9 and seeks monetary relief or even rescission of the merger. Another typical context in which 14a-9 litigation arises is the annual election of directors.¹⁶

The courts have been sensitive to the legislative purpose of the proxy rules.¹⁷ They have been earnest in their desire to insure an atmosphere of

9. SEC Rule 14a-6, 17 C.F.R. § 240.14a-6 (1977).

10. SEC Rule 14a-9(b), 17 C.F.R. § 240.14a (1977) states, "[t]he fact that a proxy statement . . . has been filed with or examined by the Commission shall not be deemed a finding by the Commission that such material is accurate or complete."

11. Part of the reason for this is reflected in the testimony of the Chairman of the Commission in 1955:

As a matter of policy the Commission has been reluctant to initiate litigation during a proxy fight in the absence of a material violation of the rules It springs in part from an unwillingness to inject the Commission into an election campaign unless a material violation of the rules is involved.

Stock Market Study (Corporate Proxy Contests): Hearings on S.879 Before a Subcomm. of the Senate Comm. on Banking and Currency, 84th Cong., 1st Sess. 1552 (1955) (statement of J. Sinclair Armstrong).

12. J.I. Case Co. v. Borak, 377 U.S. 426 (1964). See generally Comment, *Causation and Liability in Private Actions for Proxy Violations*, 80 YALE L.J. 107 (1970).

13. See, e.g., Ainslie v. Sandquist, 270 F. Supp. 382 (D. Mass. 1967) (proxy rule action involving insurgent management and former management over election of directors). See also notes 14-16 *infra*.

14. See, e.g., Smallwood v. Southdown, Inc., 382 F. Supp. 1106 (N.D. Tex. 1972), *aff'd sub nom.* Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974) (plaintiffs take nothing in a 14a-9 action involving merger); Colonial Realty Corp. v. Baldwin-Montrose Chem. Co., 312 F. Supp. 1296 (E.D. Pa. 1970) (granting plaintiff's motion for summary judgment as to liability for federal proxy rule violation in corporate merger); Berman v. Thomson, 312 F. Supp. 1031 (N.D. Ill. 1970) (summary judgment in favor of plaintiff-shareholders for proxy rule violation in connection with merger).

15. See, e.g., Laurenzano v. Einbender, 448 F.2d 1 (2d Cir. 1971) (shareholders' derivative action brought after purchase of another corporation's assets, held for defendants due to failure to prove material misrepresentation in proxy solicitations); Knauff v. Utah Constr. & Mining Co., 408 F.2d 958 (10th Cir.), *cert. denied*, 396 U.S. 831 (1969) (class action by minority shareholders seeking to void completed merger and to impress certain properties with a constructive trust).

16. See, e.g., Elgin Nat'l Indus., Inc. v. Chemetron Corp., 299 F. Supp. 367 (D. Del. 1969) (action for temporary and final injunction to restrain defendants from voting proxies at annual shareholders' meeting).

17. See, e.g., Klaus v. Hi-Shear Corp., 528 F.2d 225 (9th Cir. 1975) (considering purpose of § 14(a), but reversing trial court's grant of injunctive relief to plaintiff shareholders); Browning

"fair play" in the solicitation of proxies so that competing interests have equal opportunities "to communicate with and thereby influence the shareholders in the exercise of their corporate suffrage rights."¹⁸ The maxim "for every wrong, there is a remedy" is tested in the attempt to structure a remedy for the injured shareholder. The myriad complexities of litigation brought under rule 14a-9 place an onerous task upon the shareholder who seeks to enforce his proxy rights.¹⁹

This Comment explores the various remedies available to the shareholder who brings an action under rule 14a-9 and analyzes representative cases to aid the shareholder in selecting the most advantageous remedy. The extent to which judicial sensitivity to the competing interests involved affects the relief granted is noted throughout the Comment.

I. INJUNCTIVE RELIEF

By the time a shareholder reaches the courthouse he has been embroiled in a bitter battle in which the outcome often means corporate life or death. The shareholder may be a part of the faction opposing the liquidation or sale of the corporate assets, or he may be one that is supporting an insurgent slate of directors. It is in this context that the shareholder seeks a judicial solution to support his position. Increasingly, the most likely peg on which the minority shareholder can hang his cause of action is a challenge to the proxy instrument issued by the opposing faction.²⁰ By showing a violation of rule 14a-9 the shareholder may be able to enjoin scheduled shareholders' meetings, rescind corporate mergers, or invalidate the election of directors. The courts have been responsive to the context in which these actions arise.²¹ In granting injunctive relief, or more often in refusing such relief, the courts have been aware that "what is generally involved in a proxy fight is a bitterly fought contest between groups who have substantial financial inter-

Debenture Holders' Comm. v. Dasa Corp., 524 F.2d 811, 816 (2d Cir. 1975) (giving § 14(a) broad construction to allow private policing but affirming dismissal of shareholders' action); Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975) (reversed lower court judgment dismissing complaint alleging proxy rule violations in connection with merger).

18. See, e.g., Reserve Life Ins. Co. v. Provident Life Ins. Co., 499 F.2d 715, 725-26 (8th Cir.), *cert. denied*, 419 U.S. 1107 (1974) (solicitations for extension of voting trust within scope of proxy rules). See also Tanzer v. Haynie, 405 F. Supp. 650, 656 (S.D.N.Y. 1976) (complaint did state proxy rule violation cause of action); Levin v. Metro-Goldwyn-Mayer, Inc., 264 F. Supp. 797 (S.D.N.Y. 1967), *discussed in note 60 infra*.

19. The federal courts have candidly recognized the complexities involved in the proxy rules area. For example, in Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (2d Cir. 1973), the court cites several 14a-9 cases which "attest to the problems which the recognition of a private right of action for violation of § 14(a) in *J.I. Case Co. v. Borak* have thrust upon the federal courts . . ." *Id.* at 1284 (citations omitted).

20. See, e.g., Rosenblatt v. Northwest Airlines, Inc., 435 F.2d 1121 (2d Cir. 1970). *Rosenblatt* involved an attempt by minority shareholders to block the merger of Northeast Airlines, Inc. into Northwest Airlines, Inc. by alleging violations of both §§ 10(b) and 14 of the Securities Exchange Act. The court affirmed the lower court's denial of a motion for an injunction on the ground that the proxy statement was not materially false and misleading.

21. See, e.g., General Time Corp. v. Talley Indus., Inc., 403 F.2d 159 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969). General Time Corporation sought to enjoin the use of proxies by an independent stockholders' committee organized by Talley to elect directors to General Time Corporation and ultimately to merge or combine with General Time Corporation.

ests at stake."²² The opinions reflect that the injury complained of is read in light of these circumstances.²³

Until a private cause of action was recognized in *J.I. Case Co. v. Borak*²⁴ there were few cases in which a shareholder was successful in his attempt to enjoin the voting of proxies.²⁵ The Securities Exchange Act of 1934 conferred upon the Commission the authority to enjoin without bond any acts or practices in violation of the act.²⁶ *Borak*, however, opened the way to private injunctive relief upon violation of the proxy rules.²⁷ The Supreme Court, holding that it was the duty of the courts to provide "such remedies as are necessary to make effective the congressional purpose,"²⁸ opened the door to the issuance of temporary restraining orders, preliminary injunctions, and permanent injunctions²⁹ in actions founded on a violation of rule 14a-9.

The shareholder seeking injunctive relief faces federal as well as state statutes requiring the posting of security to protect the enjoined party from damages it might sustain as a result of a wrongful injunction. Under rule 65(c) of the Federal Rules of Civil Procedure the district court judge has discretion to require security from the applicant seeking a temporary restraining order or a preliminary injunction.³⁰ The amount of security required will vary with the potential costs and damages which might be incurred by a party wrongfully enjoined or restrained. When the shareholder seeks to enjoin a merger, the security required can be prohibitive. Consequently, many shareholders would be unable to avail themselves of this equitable remedy if courts rigidly applied the provisions. The courts have, however, at times exercised their equitable discretion to relieve the shareholders from this prohibitive requirement.³¹

State laws requiring security for costs in derivative actions have also been an obstacle for obtaining injunctive relief.³² In *Cohen v. Beneficial Industrial*

22. *Mack v. Mishkin*, 172 F. Supp. 885, 886 (S.D.N.Y. 1959).

23. In *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d 159, 162 (2d Cir. 1968), *cert. denied*, 383 U.S. 1026 (1969), the court commented: "[I]ssuers of such [proxy] statements should be held to fair accuracy even in the hurly-burly of election contests."

24. 377 U.S. 426 (1964).

25. See *Mack v. Mishkin*, 172 F. Supp. 885 (S.D.N.Y. 1959) (dissident shareholder group was allowed to bring injunctive action under rule 14a-9, but could not meet required showing of probable success).

26. Securities Exchange Act of 1934, § 21(d), 15 U.S.C. § 78u(d) (1977).

27. The Court in *Borak* stated "[p]rivate enforcement of the proxy rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." 377 U.S. at 432.

28. *Id.* at 433.

29. See FED. R. CIV. P. 65.

30. FED. R. CIV. P. 65(c).

31. Under rule 65(c), which requires security for the issuance of a restraining order or preliminary injunction, the district judge has discretion in each case to waive the requirement. See generally *Urbain v. Knapp Bros. Mfg. Co.*, 217 F.2d 810 (6th Cir. 1954), *cert. denied*, 349 U.S. 930 (1955); *Bivins v. Board of Public Educ.*, 284 F. Supp. 888 (M.D. Ga. 1967); *Tennessee Pub. Serv. Comm'n v. United States*, 275 F. Supp. 87 (W.D. Tenn. 1967). See also *Bartels v. Biernat*, 405 F. Supp. 1012 (D. Wis. 1975); *Bass v. Richardson*, 338 F. Supp. 478 (S.D.N.Y. 1971). From these cases it can be noted that the court usually is persuaded by the congressional policy behind enacting a remedial statute so that it will exercise its discretion to open the courts to the class of people the Congress intended to protect.

32. The state statutes typically allow a corporate defendant in a shareholder's derivative action to require that the complainant give security for the reasonable expenses, including counsel fees, which may be incurred in connection with the action.

*Loan Corp.*³³ the Supreme Court upheld a New Jersey security law which required a shareholder suing derivatively and owning less than five percent of the value of the outstanding shares with a dollar value of less than \$50,000 to give security for reasonable expenses and counsel fees which the corporation might reasonably be expected to incur. Many shareholders who found the state law prohibitive questioned the constitutionality of applying the state law in light of the comprehensive federal legislation dealing with the regulation of the securities field. In *McClure v. Borne Chemical Co.*³⁴ the Third Circuit held that neither section 10(b) nor section 29(b) of the 1934 Securities Exchange Act should be construed to allow state security for expense statutes to apply to such cases; the court reasoned that the federal statute was paramount to the state's right to impose a limitation upon the shareholder. Three years later, in *Borak*, the Supreme Court affirmed a lower court decision³⁵ which had held Wisconsin's statute requiring security for expenses inapplicable in light of the federal act. Even when the federal security for costs rule is applicable, the shareholder might circumvent the requirement by filing an affidavit declaring himself a pauper of the court.³⁶

The federal courts have applied general principles of equity jurisdiction in ruling on a shareholder's application to enjoin the shareholders' meeting because of a proxy violation.³⁷ This means that the shareholder must show that he is without an adequate remedy at law and that he will suffer irreparable injury if equitable relief is not afforded to him.³⁸ A three-prong test is applied for the issuance of a preliminary injunction.³⁹ First, the plaintiff-stockholders must show that they are likely to prevail on the ultimate relief sought. Opinions vary on whether the plaintiff must show that the chance for success is a "fair prospect"⁴⁰ or a "reasonable probability"⁴¹ or "clear and convincing,"⁴² but the plaintiff must convince the court that he is likely to prevail on the merits after a plenary adjudication. This prong is the most difficult to meet and has been an insurmountable obstacle to numerous shareholders seeking preliminary relief by way of an injunction.⁴³ The burden on the plaintiff is analogous to the burden on a movant for summary

33. 337 U.S. 541 (1949).

34. 292 F.2d 824 (3d Cir.), *cert. denied*, 368 U.S. 939 (1961).

35. *Borak v. J.I. Case Co.*, 317 F.2d 838 (7th Cir. 1963).

36. 28 U.S.C. § 1915(a) (1970) provides (emphasis added):

Any court of the United States may authorize the commencement, prosecution or defense of any suit, *action or proceeding*, civil or criminal, or appeal therein, without prepayment of fees and costs *or security therefor*, by a person who makes affidavit that he is unable to pay such costs or give security therefor.

Failure to grant or deny benefit of this section enabling a party to proceed in forma pauperis has been held in a civil action in federal court to rest with the discretion of the district courts. *See Williams v. Field*, 394 F.2d 329 (9th Cir.), *cert. denied*, 393 U.S. 891 (1968).

37. *See* notes 38-50 *infra* and accompanying text.

38. *See* note 46 *infra* and accompanying text.

39. For an early opinion applying the three-prong test see *Mack v. Mishkin*, 172 F. Supp. 885 (S.D.N.Y. 1959).

40. *Id.*

41. *See, e.g., Elgin Nat'l Indus., Inc. v. Chemetron Corp.*, 299 F. Supp. 367, 373 (D. Del. 1969); *Empire Gas Co. v. Gray*, 29 Del. Ch. 95, 46 A.2d 741 (1946).

42. *Dunn v. Decca Records, Inc.*, 120 F. Supp. 1 (S.D.N.Y. 1954).

43. *See, e.g., Klaus v. Hi-Shear Corp.*, 528 F.2d 225, 232 (9th Cir. 1975) ("[b]ecause he has no possibility of success on these theories, a preliminary injunction may not be based on them").

judgment. The shareholder must at least make out a prima facie case entitling him to relief, but may even be required to show the nonexistence of any substantial issues of fact.⁴⁴ In an area as complex as litigation under rule 14a-9, the plaintiff-shareholder is hard pressed to meet this burden and show a substantial likelihood of ultimate success.⁴⁵

The second prong requires that the plaintiff-shareholder show he will suffer irreparable harm if preliminary relief is not granted.⁴⁶ This requirement normally does not bar a large number of actions because most shareholders are seeking an order adjourning the shareholder meeting to a later date.⁴⁷ The action is usually brought only a few days prior to the scheduled meeting and, therefore, shareholders have found little difficulty in demonstrating the need to avoid irreparable injury. One notable exception is seen where injunctive relief is denied on grounds that the remedy of rescission is available to the shareholder.⁴⁸ For example, where a shareholder seeks to enjoin a scheduled shareholders' meeting in which a vote will be taken on the acquisition of two business entities by the corporation, injunctive relief might be denied on grounds that the shareholder can have the purchase rescinded if he shows a violation of rule 14a-9 at trial.⁴⁹ This reasoning will often whipsaw the plaintiff-shareholder because he may later be denied rescissionary relief, notwithstanding his ultimate success on the merits. When the shareholder has shown liability and asked for rescission, he may be denied this relief because of the harmful consequences a rescission would have on the corporation.⁵⁰

This concern for harm to the defendant-corporation raises the third prong of the test. The third prong requires that the shareholder show that the

44. In *Mack* the court denied preliminary injunctive relief and said:

There are substantial issues of fact existing, the full resolution of which can only be had upon a full scale trial on the merits. I am aware that there is authority for granting preliminary relief, even when such substantial questions remain, so long as plaintiffs have made out a prima facie case.

172 F. Supp. at 888; see *SEC v. May*, 134 F. Supp. 247 (S.D.N.Y. 1955), *aff'd*, 229 F.2d 123 (2d Cir. 1956).

45. For a rare example of a court granting a preliminary injunction denying the voting of proxies solicited by management because of a misleading proxy statement see *Cooke v. Teleprompter Corp.*, 334 F. Supp. 467 (S.D.N.Y. 1971).

46. See, e.g., *Klaus v. Hi-Shear Corp.*, 528 F.2d 225, 232 (9th Cir. 1975) (reversing lower court's order granting injunction on grounds that plaintiff failed to demonstrate irreparable harm); *Levin v. Metro-Goldwyn-Mayer, Inc.*, 264 F. Supp. 797, 804 (S.D.N.Y. 1967) (denying injunctive relief for alleged proxy rule violations in part due to failure to show irreparable harm).

47. But see *Levin v. Metro-Goldwyn-Mayer, Inc.*, 264 F. Supp. 797 (S.D.N.Y. 1967). In *Levin*, discussed in note 61 *infra*, the court denied injunctive relief in part due to a failure by plaintiffs to show an irreparable injury.

48. See *Abramson v. Nytronics, Inc.*, 312 F. Supp. 519 (S.D.N.Y. 1970); *Mack v. Mishkin*, 172 F. Supp. 885 (S.D.N.Y. 1959). In *Abramson* a shareholder sued to enjoin the holding of a shareholders' meeting which was to approve a merger of two corporations. The court stated that since the acquisition would consist of two separate business entities which would be operated separately, there would be little difficulty in returning to a status quo if the acquisition were set aside after trial. This fact persuaded the court to deny the shareholders' prayer for a preliminary injunction.

49. For a discussion of rescissionary relief see notes 111-125 *infra* and accompanying text.

50. See, e.g., *Swanson v. American Consumers Indus., Inc.*, 475 F.2d 516 (7th Cir. 1973), discussed in notes 119-20 *infra* and accompanying text. But see *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975) (court rejected argument that by failing to seek injunction plaintiff would be precluded from seeking rescission of completed merger).

benefit he would derive from injunctive relief outweighs the harm that the defendant-corporation will suffer as a result of the injunction. This "balancing of the equities" often works to the shareholders' detriment since many times the plaintiff-shareholders own a minute interest in the outstanding shares of the corporation, whereas the corporate defendant may have assets valued at hundreds of millions of dollars. In order to even the scales somewhat, individual shareholders have often framed their actions on behalf of a class of similarly situated shareholders. The class action may be essential to the plaintiff's action when the court applies a balancing formula before exercising its equity jurisdiction.

*Twentieth Century Fox Film Corp. v. Lewis*⁵¹ furnishes a modern example of the application of the three-prong analysis in an action for violation of rule 14a-9. Twentieth Century Fox Film Corporation sought to enjoin an insurgent committee from soliciting any proxies from shareholders of its common stock until the committee's proxy statement complied with the proxy rules. The court denied injunctive relief, finding that the plaintiffs failed to meet the three-prong test. The court found that the plaintiffs failed to make a "clear showing of probable success on the trial."⁵² After concluding that the chances that plaintiff would fail to prove its allegations at trial were "at least even"⁵³ with its chance of success, the court held that the plaintiffs had failed to meet the first prong of the test. Moreover, the court denied equitable relief because the plaintiffs failed to specify how they would suffer irreparable injury.⁵⁴ The court then applied a balancing test and dealt the final and fatal blow to the plaintiffs. The court found that the defendant-committee would be injured more by the injunction than the plaintiffs would be benefited. The court considered the fact that the defendants "would be at least partially discredited in the eyes of the shareholders who, being ignorant of the law, would view the injunction as a favorable adjudication of plaintiff's claim."⁵⁵

In *Dunn v. Decca Records, Inc.*⁵⁶ a shareholder sought a preliminary injunction against a shareholders' meeting scheduled four days later. The shareholder had alleged that the proxy statement issued by the defendant was false and misleading with respect to the corporate president's salary in that the figure listed did not include the cost of maintaining a hotel suite as additional compensation. In denying plaintiff's application for a preliminary injunction, the court imposed a "clear and convincing"⁵⁷ burden on the shareholder to show that she would ultimately prevail in her action against the corporation. The court characterized the injunction as an "extraordinary remedy" which should be used "with moderation and only in a clear and plain case."⁵⁸ The court may have been influenced by the fact that the

51. 334 F. Supp. 1398 (S.D.N.Y. 1971).

52. *Id.* at 1399.

53. *Id.* at 1402.

54. *Id.*

55. *Id.* at 1402-03. Similar reasoning was followed in *Committee for New Management of Butler Aviation v. Widmark*, 335 F. Supp. 146 (E.D.N.Y. 1971).

56. 120 F. Supp. 1 (S.D.N.Y. 1954).

57. *Id.* at 3.

58. *Id.*

plaintiff owned only 200 shares of Decca Records and commenced the action just four days prior to the regularly scheduled annual stockholders' meeting. The judge ruled on the application for an injunction the day of the scheduled meeting. The judge expressed his concern for the equities of the corporation and said "[I]f my decision were otherwise, . . . confusion, anxiety and uncertainty would result as well as substantial expense to the company."⁵⁹ Although this balancing of the equities is probably always considered by the courts, it may often be an unexpressed factor.

The courts apparently are hesitant to indicate openly that the number of shares owned by the plaintiff enters into whether injunctive relief will be granted; perhaps this is because it permits the decisions to be rendered on a case-by-case basis. Since the relief sought is equitable, the courts should not feel restrained to acknowledge openly this balancing process, and recognize that equitable relief legitimately rests in the discretion of the court.

A good example of a court's balancing the equities and candidly giving weight to the number of shares owned by the plaintiff is *Poirier v. Welch*.⁶⁰ The defendant corporation had approximately 130,000 shareholders with some ten million shares of stock outstanding. The court balanced these facts against the plaintiff's ownership of only 210 shares.

This disproportion is a matter that the Court may well consider in determining the equities of the present application. On the other hand, the corporation has gone to considerable expense in sending out notices and proxies for the meeting. A considerable number of shareholders have replied that they will be personally present and are planning to do so. It would obviously be a great inconvenience and an unnecessary expense to the corporation and the stockholders who intend to be present if this Court were to stay the holding of the meeting.⁶¹

When a court invokes this type of balancing the small shareholder will inevitably be denied equitable relief. This fact should make clear the great advantage in bringing a class action shareholder suit since such suits are more likely to avoid the bite of the balancing test than an action by a small shareholder alone. A plaintiff-shareholder, by bringing the action on behalf of all shareholders similarly situated, will be much better equipped to demonstrate to the court that the benefits to be derived by granting the injunctive relief outweigh the harm which will be caused the defendant-corporation.

In *Curtin v. American Telephone & Telegraph Co.*⁶² the holder of a single share of AT&T common stock sued the corporation to enjoin the scheduled

59. *Id.*

60. 233 F. Supp. 436 (D.D.C. 1964).

61. *Id.* at 439. See also *Levin v. Metro-Goldwyn-Mayer, Inc.*, 264 F. Supp. 797 (S.D.N.Y. 1967), where six stockholders of MGM sought temporary injunctive relief to prevent the defendant-corporation from using the offices and employees of MGM to solicit proxies in an upcoming annual stockholders' meeting. The court's balancing of the harm to the defendant and the benefits to be derived by the plaintiff is seen in the following statement:

It is the concern of the law and of the Court that [the shareholders] be fully and truthfully informed as to the merits of the contentions of those soliciting their proxy. It is equally important that the Court should not unnecessarily exercise its injunctive power in such matters lest such judicial action operate to unduly influence a stockholder's decision as to which faction should receive his proxy.

Id. at 801. The court found that the plaintiffs failed to show a right to relief or any irreparable harm and, therefore, denied the relief sought.

62. 124 F. Supp. 197 (S.D.N.Y. 1954).

annual stockholders' meeting in order to block adoption of a proposed pension plan. As might be expected under a balancing approach, the court denied injunctive relief and allowed the meeting to take place as scheduled. The court stated that to do otherwise would "seriously upset pending plans and purposes of one of the world's largest corporations"⁶³ and would burden the company by resulting liabilities estimated at approximately \$100,000. "[M]oreover, confusion, uncertainty and even anxiety would probably disturb thousands of the stockholders of the defendant."⁶⁴ The court found these consequences too potentially harmful to justify the issuance of preliminary relief.⁶⁵

It is appropriate to inquire into the validity of such a "balancing of the equities" approach in the context of proxy rule violations. Should a shareholder who will be injured by the solicitation of proxies through a false or misleading proxy statement be denied injunctive relief based upon the size of his investment? The balancing process includes a weighing of the public's interest as well as the interests of the shareholder and the corporation. Certainly, the public has an interest in the protection of its investments. The balancing process, however, should also weigh the public's interest in the vitality of the economic sector. The courts must be mindful of the economic impact to the business community of an approach which ignores the potential expense and consequences to the corporation which would result from the ability of a small shareholder to paralyze corporate business. Even though the purpose of the proxy rules is to guarantee full disclosure so that the investor may cast an informed vote, the remedies available to enforce the rules must be applied with a great deal of flexibility.⁶⁶

Since the first prong of the three-prong analysis requires a showing of the probability that the plaintiff will ultimately prevail, the question of liability clearly enters into a court's determination to award preliminary injunctive relief. A review of many of the cases denying injunctive relief to shareholders alleging a violation of rule 14a-9 indicates that the courts' decisions are often framed in terms of the plaintiff's failure to show that the omission or falsity was "material,"⁶⁷ as the rule contemplates. The courts have applied a different burden of materiality depending upon their views of the equities,

63. *Id.* at 197.

64. *Id.*

65. The courts have shown concern for the effect postponement of the shareholders' meeting will have on the shareholders not involved in the litigation. In *Abramson v. Nytronics, Inc.*, 312 F. Supp. 519, 524 (S.D.N.Y. 1970), the court said, "the issuance of an injunction may be understood by [the] shareholders as evidence that we are of the opinion that there has been wrongdoing on the part of [the] management."

66. In *Hecht Co. v. Bowles*, 321 U.S. 321 (1944), the Supreme Court commented on the value of flexible equitable jurisdiction.

The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. . . .

The qualities of mercy and practicality have made equity the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims.

Id. at 329-30.

67. See, e.g., *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d 159 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969); *Sunray DX Oil Co. v. Helmerich & Payne, Inc.*, 398 F.2d 447 (10th Cir. 1968).

so that this ostensible reason for the court's decision often appears to involve the same sort of balancing as was discussed above.

The two most widely held tests of materiality are: (1) that material facts include all facts which a reasonable shareholder *might* consider important,⁶⁸ and (2) whether a reasonable man *would* consider the fact important in deciding on his course of conduct.⁶⁹ The Supreme Court has recently announced that the proper test of materiality is the "would" test. In *TSC Industries, Inc. v. Northway, Inc.*⁷⁰ the Court held:

[A]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.⁷¹

The test of materiality adopted by the Court makes it more difficult for the shareholder to prevail on the liability issue. Because the three-prong test must be met before an injunction will issue, the adoption of the "would" test will impose a heavier burden on the shareholder seeking a preliminary injunction. The Court's opinion can be read as suggesting that the "would" test of materiality was followed to avoid setting the threshold of liability too low.⁷² Now that the Court has adopted this higher standard there might be less of an opportunity for the lower courts to apply varying standards based upon balancing the equities.

II. MONETARY RELIEF

Although injunctive relief may be the most appealing remedy for the minority shareholder, the foregoing discussion indicates some of the difficulties in obtaining such relief. Therefore, a shareholder will often seek monetary damages along with injunctive relief. The measure of damages recoverable by a shareholder injured by a false or misleading proxy statement is similar to traditional damage theories,⁷³ albeit somewhat more complex.

68. See, e.g., *Northway, Inc. v. TSC Indus., Inc.*, 512 F.2d 324 (7th Cir. 1975) *rev'd*, 426 U.S. 438 (1976); *Sunray DX Oil Co. v. Helmerich & Payne, Inc.*, 398 F.2d 447 (10th Cir. 1968); *Ross v. Longchamps, Inc.*, 336 F. Supp. 434, 441 (E.D. Mo. 1971); *Colonial Realty Corp. v. Baldwin-Montrose Chem. Co.*, 312 F. Supp. 1296 (E.D. Pa. 1970).

69. See, e.g., *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974); *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973); *Richland v. Crandall*, 262 F. Supp. 538 (S.D.N.Y. 1967).

70. 426 U.S. 438 (1976).

71. *Id.* at 449.

72. The liability for a rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also, management's fear of exposing itself to substantial liability may cause it simply to bury the shareholder in an avalanche of trivial information—a result that is hardly conducive to informed decision making. *Id.* at 448-49.

73. The Supreme Court, in *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 64 (1975) (citing *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970)), said that "the questions of liability and relief are separate in private actions under the securities laws, and . . . the latter is to be determined according to traditional principles."

One common measure of damages is the "out-of-pocket" expenses sustained by the shareholder.⁷⁴ A shareholder who has suffered a loss on the value of his investment because of the decline in the value of his stock will only be made whole if he is able to recover the difference between the true market value of the stock and its value if the proxy statement had not been false or misleading with respect to material facts.

The greatest measure of damages from the shareholder's point of view is restitution. This measures the shareholder's damages by "disgorging the profits" realized by the violation of rule 14a-9 and awarding the amount to the injured shareholders. This remedy often results in a windfall for the shareholder, yet it is an often invoked measure of damages for the shareholder seeking monetary relief under the federal securities acts and regulations.⁷⁵ Of course, the shareholder must always base his claim upon actual damages, that is, a financial loss.⁷⁶ The Supreme Court in *Mills v. Electric Auto-Lite Co.*⁷⁷ said, "In short, damages should be recoverable only to the extent that they can be shown."⁷⁸ The Court recognized that trial courts have the power to order an accounting to determine the shareholder's loss due to materially false or misleading proxy statements.

In *Gould v. American-Hawaiian S.S. Co.*⁷⁹ certain shareholders brought a class action suit alleging that they had been damaged by a false and misleading proxy statement issued by the defendant-corporation and its directors. The plaintiffs alleged that a proxy statement issued by the defendants seeking approval of a merger of their corporation into R.J. Reynolds Tobacco Co. was false and misleading in that it failed to disclose that certain directors of the target company were receiving \$50 in cash per share for their stock while the other common shareholders were receiving Reynolds preferred stock. The court found that the Reynolds preferred stock had a fair market value of \$41.75 on the first day of trading after the merger was approved. After finding that the defendants' failure to disclose this information in the proxy statement was a violation of rule 14a-9, the court then determined that the defect in the proxy statement resulted in the defendants' receiving a premium on their shares of \$8.25 per share. The court allowed the plaintiffs to recover their pro rata share of the premium realized by the

74. See *Kohler v. Kohler Co.*, 208 F. Supp. 808 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963), holding that the shareholder must show a direct financial injury proximately caused by a violation of rule 14a-9 before he is entitled to monetary relief. See generally Note, *Private Remedies Available Under Section 14(a) of the Securities and Exchange Act of 1934*, 55 IOWA L. REV. 657 (1970).

75. See *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761 (3d Cir. 1976); *Ohio Drill & Tool Co. v. Johnson*, 498 F.2d 186 (6th Cir. 1974); *Zeller v. Bogue Elec. Mfg. Corp.*, 476 F.2d 795 (2d Cir.), *cert. denied*, 414 U.S. 908 (1973); *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

76. See *Schy v. Susquehanna Corp.*, 419 F.2d 1112 (7th Cir.), *cert. denied*, 400 U.S. 826 (1970), where dismissal of complaint alleging federal proxy rule violations for failure as a matter of law to show damages was affirmed on appeal. *But cf.* *Berman v. Thomson*, 312 F. Supp. 1031, 1033 (N.D. Ill. 1970) ("a plaintiff who can prove a violation of the proxy statute is entitled to a judgment regardless of financial injury").

77. 396 U.S. 375 (1970).

78. *Id.* at 389.

79. 535 F.2d 761 (3d Cir. 1976).

defendants in order to compensate them for the loss of an opportunity to secure a more favorable merger agreement.⁸⁰

The court in *Gerstle v. Gamble-Skogmo, Inc.*⁸¹ refused to allow the plaintiff-shareholders a recovery based on the highest intermediate value of the assets of the merged corporation between the date of the merger and the date of judgment. Plaintiffs' measure of damages would have allowed a recovery of the post-merger appreciation of the merged corporation's assets on the theory that had it not been for the false and misleading proxy which led to the merger, they would have realized this appreciation as profits. The court found this argument "too simple,"⁸² stating that "an adequate disclosure would not necessarily have led to an abandonment of the idea of a merger . . . the utmost consequences would likely have been a demand for postponement [of the merger]"⁸³ Further, the court would not assume that the shares would have been sold at their highest value between the time of the merger and the judgment.⁸⁴ Such a measure may be allowed, but only in certain limited circumstances; for example, when the value of the assets steadily appreciates from the date of the merger.⁸⁵ The court determined that the proper measure of plaintiffs' recovery was the value of the profits realized by the defendants, plus pre-judgment interest.

*Pierce J. LeLandais & Co. v. MDS-Atron, Inc.*⁸⁶ held that the plaintiff-shareholders were under an obligation to mitigate damages arising out of their acquiescence in a merger caused by a proxy statement violative of rule 14a-9. A thirty-day period running from the effective date of the registration statement was imposed during which the plaintiffs should have disposed of their stock to mitigate their damages. Those shareholders who held their stock for longer than thirty days were denied recovery for any decrease in value after the thirty-day period. The court treated those holding their stock beyond this period as having made a new investment decision.⁸⁷ The court, therefore, attempted to place the plaintiffs in the same position they would have enjoyed had they received the omitted information in the proxy solicitation.

Although the shareholder is entitled to be put in substantially the same position he would have occupied absent the fraud,⁸⁸ the shareholder's problem is that by the inherent nature of the open market system his investment is uncertain, and his actual damages are often too speculative and remote to be recovered. The principle that a wrongdoer should not profit from his own

80. *Id.* at 784 n.29.

81. 478 F.2d 1281 (2d Cir. 1973).

82. *Id.* at 1305.

83. *Id.*

84. The court dispels the notion that "the highest intermediate value" is proper, and refused to follow *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968). 478 F.2d at 1305 n.26. *Myzel* had held that a jury may consider subsequent increases in value of stock in measuring a 10b-5 plaintiff's damages for sale of a security without full disclosure from the defendant. The court said that this theory is too "untenable and speculative to support an award of damages." *Id.* at 1305.

85. *Id.*

86. 387 F. Supp. 1310 (S.D.N.Y. 1974), *modified*, 543 F.2d 421 (2d Cir. 1976), *cert. denied*, 97 S. Ct. 786, 50 L. Ed. 2d 778 (1977).

87. *Id.* at 1331.

88. RESTATEMENT OF RESTITUTION § 151 (1937).

misconduct, however, militates in favor of requiring that the profits realized by the wrongdoer be disgorged to the benefit of the shareholder.

The injured shareholder may also seek punitive damages in addition to the recovery of the wrongdoer's profits. A shareholder's allegations that a false proxy statement was used to achieve an illegal merger and that other shareholders had breached their fiduciary duty by discontinuing their lawsuit to enjoin the merger has been held sufficient to state a claim for punitive damages.⁸⁹ The greatest barrier to the recovery of punitive damages for a rule 14a-9 violation comes from language in the 1934 Act.⁹⁰ Section 28 provides as follows: "[N]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his *actual damages* on account of the act complained of."⁹¹ This statutory prohibition has been interpreted by the courts to prevent the recovery of punitive damages for violation of the Securities Exchange Act of 1934.⁹² A recent inroad, however, has been made by way of recovering punitive damages under a state law claim.⁹³ One writer has concluded that the recovery of punitive damages should not be allowed because harsh penalties already exist for violation of the federal securities laws.⁹⁴ The writer goes on to suggest that punitive damage recoveries would have only a "marginal effect" on deterring undesirable conduct. But in light of the difficulty a shareholder has in recovering for a violation of rule 14a-9, punitive damages may well be necessary to provide the beneficial effect of deterring false and misleading proxy solicitations.⁹⁵ Such relief, however, is unlikely to be forthcoming without a congressional amendment to the 1934 Act.

Another element of monetary relief which a shareholder may seek for violation of rule 14a-9 is the recovery of attorney's fees. The recovery of attorney's fees can be founded on one of two theories. First, that the

89. *Miller v. Steinbach*, 268 F. Supp. 255 (S.D.N.Y. 1967).

90. Securities Exchange Act of 1934, § 28, 15 U.S.C. § 78bb(a) (1970).

91. The term "actual damages" has most often been interpreted as "out-of-pocket" expenses. *Abrahamson v. Fleschner*, 392 F. Supp. 740 (S.D.N.Y. 1975).

92. See *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761 (3d Cir. 1976); *Flaks v. Koegel*, 504 F.2d 702 (2d Cir. 1974); *Wolf v. Frank*, 477 F.2d 467 (5th Cir.), *cert. denied*, 414 U.S. 975 (1973); *Reid v. Mann*, 381 F. Supp. 525 (N.D. Ill. 1974); *Burkhart v. Allson Realty Trust*, 363 F. Supp. 1286 (N.D. Ill. 1973).

93. See, e.g., *Young v. Taylor*, 466 F.2d 1329 (10th Cir. 1972); *In re Caesars Palace Sec. Litigation*, 360 F. Supp. 366 (S.D.N.Y. 1973). In *Young* a suit for monetary relief arising out of an alleged fraudulent securities scheme was brought under § 10(b) of the 1934 Act, the Utah Blue Sky Law, UTAH CODE ANN. § 61-1-22(1)(b) (1953), and on common law fraud principles. In addition to an award of \$263,800 in actual damages, the trial court awarded \$50,000 punitive damages. The Tenth Circuit would not construe § 28 of the 1934 Act as destroying investors' rights under state law claims and, therefore, sustained the award of punitive damages and attorney's fees as permitted under the Utah Blue Sky Law. 466 F.2d at 1338.

Caesars Palace cites *Young v. Taylor* in support of its holding that punitive damages are recoverable where the complaint alleges common law fraud in addition to a violation of the federal securities laws. Since the applicable state law allowed recovery of punitive damages for common law fraud, the court held the plaintiff's prayer for punitive damages was proper. 360 F. Supp. at 394.

94. Comment, *Punitive Damages in Implied Civil Actions Under the Securities Acts*, 74 DICK. L. REV. 466 (1970).

95. See Note, *Private Enforcement of the Federal Proxy Rules: Remedial Alternatives*, 15 WM. & MARY L. REV. 286 (1973), where punitive damages as well as recovery for attorney's fees is suggested as a means of encouraging private enforcement of the proxy rules.

shareholder who has brought the action on behalf of all shareholders should be entitled to recover his expenses from the other shareholders.⁹⁶ The other rationale allows the recovery of attorney's fees from the defendant as a penalty for his wrongdoing. This rationale is difficult to support in light of the general reluctance by the courts to award punitive damages in the 14a-9 context.

The allowance of attorney's fees from the fund recovered when a suit is maintained as a class action is not truly a recovery of attorney's fees since it merely allows the plaintiff to skim a portion off the top of his recovery in reimbursement of his expenses. This benefit for the shareholder bringing the suit on behalf of a class of shareholders was recognized by the Supreme Court as early as 1882.⁹⁷ In *Mills v. Electric Auto-Lite Co.*⁹⁸ the majority opinion noted that "the courts have increasingly recognized that the expenses incurred by one shareholder in the vindication of a corporate right of action can be spread among all shareholders through an award against the corporation"⁹⁹

Somewhere in between these two rationales is the view that an award of attorney's fees can be justified as it supports the public's interest in the private enforcement of federal remedial legislation.¹⁰⁰ In *Mills* the Court opened the way for awarding attorney's fees, notwithstanding the absence of express statutory authorization under section 14(a) of the 1934 Act. The Court could find no legislative intent in the Act which would limit a court's power to grant attorney's fees when the court found such relief appropriate.¹⁰¹ The Court was influenced by the judicial history of a private cause of action under rule 14a-9. Because there were no "express remedial provisions which were intended to mark the boundaries of the power to award monetary relief in cases arising under the Act,"¹⁰² the courts could structure whatever remedies were appropriate. The decision is especially significant because it was concerned with the benefit of a 14a-9 action to the public, not with the benefit to the other shareholders in the class. "In short, the Court granted an award for acting as a private attorney general."¹⁰³ The effective enforcement of the 1934 Act would suggest the shifting of the attorney's fees to the successful plaintiff as a necessary part of any action which is intended to expose corporate abuse.¹⁰⁴ The Court in *Mills v. Electric Auto-*

96. *Bleznak v. C.G.S. Scientific Corp.*, 387 F. Supp. 1184 (E.D. Pa. 1974); *Bosch v. Meeker Coop. Light & Power Ass'n*, 257 Minn. 362, 101 N.W.2d 423 (1960).

97. *Trustees v. Greenough*, 105 U.S. 527 (1882). In *Greenough* the plaintiffs sued on behalf of all bondholders of the corporate defendant. The plaintiffs recovered damages for the corporation's waste and misapplication of the assets securing the corporate obligations. The Court allowed the plaintiffs to recover their costs and attorney's fees from the fund under the Court's control.

98. 396 U.S. 375 (1970).

99. *Id.* at 394.

100. See Comment, *The Allocation of Attorney's Fees After Mills v. Electric Auto-Lite Co.*, 38 U. CHI. L. REV. 316 (1971).

101. See also Comment, *The Changing American Rule Against Attorney Fee Shifting*, 28 Sw. L.J. 542 (1974).

102. *Fleischmann Corp. v. Maier Brewing Co.*, 386 U.S. 714, 721 (1967).

103. Comment, *supra* note 100, at 327.

104. See, e.g., Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784, 816 (1939) ("the award of counsel fees to the successful minority shareholder . . . is a necessary concomitant of allowing the stockholder's derivative suit, which is vital to the exposure and redress of corporate abuse").

Lite, did, however, expressly state that the allowance of attorney's fees was not meant to saddle the unsuccessful party with the expenses, but rather to impose them on the class that had benefited from the expenditure.¹⁰⁵ This language has been read by the Second Circuit as allowing only a recovery out of the successful plaintiff's fund and not a judgment against the defendant.¹⁰⁶ The Second Circuit, however, went on to say that on remand the district court could require the defendant to pay a proportion of plaintiff's attorney's fees if it is found that the defendant acted in bad faith through use of dilatory tactics during the trial.¹⁰⁷ The Act gives the district court judge discretionary power to require a party to pay costs, including reasonable attorney's fees, if he believes a suit or defense under any section of the Act was without merit.¹⁰⁸ The *Gerstle* case clearly allows a shareholder to recover from the defendant that portion of its attorney's fees expended in prosecuting against a frivolous, bad faith defense by the defendant-corporation. The court's opinion should not be read as allowing punitive damages against a defendant in a 14a-9 action for its bad faith violation of rule 14a-9. The court was certainly referring to the bad faith involved in the litigation of the suit, not the bad faith in violating the rule. The district court judge so understood the court's opinion, as is evidenced by his remarks after remand: "If there is to be any such charge [for attorney's fees], it must be predicated upon the principles enunciated in the opinion of the Court of Appeals and not for any punitive purposes."¹⁰⁹

III. RESCISSIONARY RELIEF

Perhaps the most powerful weapon in the shareholder's arsenal is rescissionary relief. This retrospective relief, when obtained by the shareholder, allows consummated corporate transactions to be "unwound."¹¹⁰ The typical context in which such relief might be sought is where a corporate merger has been approved at the shareholders' meeting. The dissatisfied shareholder may not have been aware of the material misstatement in the proxy statement until after the merger has been completed and the stock ex-

105. 396 U.S. at 396-97.

106. *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1309 (2d Cir. 1973). See also *Smith v. Manausa*, 385 F. Supp. 443 (E.D. Ky. 1974).

107. *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1309-10 (2d Cir. 1973).

108. Securities Exchange Act of 1934, § 11(e), 15 U.S.C. § 77k(e) (1970) provides:

In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant . . . if the court believes the suit on the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit

For cases supporting an award of attorney's fees for violation of securities laws see generally *Rucker v. La-Co., Inc.*, 496 F.2d 850 (8th Cir. 1974); *Klein v. Shields & Co.*, 470 F.2d 1344 (2d Cir. 1972); *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir.), cert. denied, 398 U.S. 950 (1970); *SEC v. Capital Counselors, Inc.*, 378 F. Supp. 224 (S.D.N.Y. 1974), aff'd, 512 F.2d 654 (2d Cir. 1975).

For cases not allowing recovery of attorney's fees see generally *Pierre J. LeLandais & Co. v. MDS-Atron, Inc.*, 387 F. Supp. 1310 (S.D.N.Y. 1974), modified, 543 F.2d 421 (2d Cir. 1976), cert. denied, 429 U.S. 1062 (1977); *Smith v. Manausa*, 385 F. Supp. 443 (E.D. Ky. 1974).

109. *Gerstle v. Gamble-Skogmo, Inc.*, 366 F. Supp. 638, 644 (E.D.N.Y. 1973).

110. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970).

changed pursuant to the transaction. The shareholder who finds that his stock has depreciated may be looking for judicial aid in avoiding the loss. If the shareholder can prove that the form of proxy violated section 14(a) and rule 14a-9, he may ask the court to rescind the merger. Because of the difficulty and burden imposed upon the corporations, this extraordinary remedy whereby the merger is unscrambled is threatened more often than applied.

The power to rescind a completed corporate transaction because of a violation of the proxy rules was not even recognized for some time.¹¹¹ In *Dann v. Studebaker-Packard Corp.*¹¹² the court considered the power to rescind a corporate merger, based upon a false proxy statement, in terms of subject matter jurisdiction. The court could find no evidence of a congressional intent to create a right to rescind completed mergers. The court held that the federal courts lacked jurisdiction to determine the "consequent effects of the validity or invalidity"¹¹³ of the proxies, but only had subject matter jurisdiction to consider the *validity* of the proxies solicited.¹¹⁴

The United States Supreme Court, however, held in *Mills* that retrospective relief for violation of the proxy rules should be considered in the same manner as it would be for any "similar illegality or fraud."¹¹⁵ This broad recognition of the power of the court to rescind a completed merger greatly expands the shareholders' remedies upon a violation of rule 14a-9. The Court, however, was careful to state that this remedy is within the *power* of a court in the exercise of its equity jurisdiction rather than a *right* lying with the shareholder.¹¹⁶ The Court recognized that "nothing in the statutory policy requires the court to unscramble a corporate transaction merely because a violation occurred."¹¹⁷

The Court in *Mills* leaves no guidelines for the lower federal courts to use in determining when rescission is appropriate. The Court merely states that courts are to use "the sound discretion which guides the determinations of courts of equity."¹¹⁸ The lack of clear guidelines may have contributed to the lower courts' frequent refusal to exercise this power of rescission. Shortly after the Court handed down its opinion in *Mills*, the Seventh

111. *Howard v. Furst*, 140 F. Supp. 507 (S.D.N.Y.), *aff'd*, 238 F.2d 790 (2d Cir.), *cert. denied*, 353 U.S. 937 (1956). The court stated:

There is no basis in the statute or its legislative history for an implication that Congress intended to give an individual stockholder, as an incident of his protection by proxy statement regulation, the right to rescind completed corporate transactions whenever based upon votes solicited by such statements. . . . The drastic nature of such relief and the ease with which it could have been expressly authorized if Congress had so intended all argue against such an implication.

Id. at 513.

112. 288 F.2d 201 (6th Cir. 1961).

113. *Id.* at 214.

114. For a rare example of a court's ordering a shareholders' meeting and proxies "voided" for the violation of rule 14a-9 see *Dillon v. Berg*, 326 F. Supp. 1214 (D. Del.), *aff'd*, 453 F.2d 876 (3d Cir. 1971).

115. 396 U.S. at 386.

116. *Id.*

117. *Id.* (citing the lower court opinion, 403 F.2d 429, 436 (7th Cir. 1968)).

118. The Court does suggest that the lower courts keep in mind the role of equity as "the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims." *Id.*

Circuit in *Swanson v. American Consumers Industries, Inc.*¹¹⁹ held that "the best interest of the shareholders as a whole"¹²⁰ was a proper factor to be considered by the district courts in deciding to exercise their discretionary power of rescission.

One reason often given by the courts in refusing to order a corporate merger rescinded is the doctrine of laches. In *Walpert v. Bart*¹²¹ the court refused to set a consummated merger aside, finding that the plaintiff-shareholder was barred by laches.¹²² The plaintiff owned 100 shares of the acquired corporation. On June 20, 1966, the merger was approved at the annual shareholders' meeting. Plaintiff did not initiate an action or voice his dissatisfaction until August 11, 1966, when he filed a derivative action against the acquiring corporation. The court stated that laches was appropriate because the plaintiff had lulled third parties who thought the merger was not being contested into buying stock in the open market. The plaintiff could have avoided this obstacle to rescissory relief by either (1) informing the acquiring corporation that he opposed the merger before the meeting and informing it that the proxy statement was being studied for its legality, or (2) informing the acquired corporation as soon as he decided to take legal action instead of waiting for over six weeks to file the action.¹²³

The *Walpert* decision cannot be criticized as its purpose in denying the relief is clearly to protect innocent third parties who have intervened. Some courts, however, have based their denial of preliminary injunctive relief on the grounds that the shareholder has an adequate remedy of rescission if he shows himself entitled to relief at the trial on the merits.¹²⁴ This treatment often results in the plaintiff-shareholder's being whipsawed in that he may meet the requirements shown above but still be denied rescissory relief.

IV. CONCLUSION

The courts' reasoning in the proxy rule cases, although seemingly disingenuous at times, is based in part on the courts' legitimate concern in

119. 475 F.2d 516 (7th Cir. 1973). The plaintiff-shareholder sued to rescind a reorganization agreement which provided for the merger of the corporation with another company which would result in the liquidation of the corporation's assets. The court found that the exchange ratio of five shares of the liquidating corporation's stock for one share of the acquiring company was fair and reasonable and that setting aside the merger would not be in the best interests of all of the shareholders. *Id.* at 519.

120. *Id.*

121. 280 F. Supp. 1006 (D. Md. 1967), *aff'd*, 390 F.2d 877 (4th Cir. 1968).

122. The court stated that the doctrine of laches is applicable "only when one has knowledge of his rights, but he refuses to take the necessary steps to enforce them until the other party has in good faith so changed his position that he cannot be restored to his former state if the right is enforced." *Id.* at 1017.

123. See *Occidental Life Ins. Co. v. Pat Ryan & Assoc., Inc.*, 496 F.2d 1255 (4th Cir.), *cert. denied*, 449 U.S. 1023 (1974), in which an action was brought under the fraud provisions of the 1934 Act. The court denied the plaintiff's request for rescission, applying the doctrine of laches as a bar to such relief. The court placed the burden on the plaintiff to show that he had acted with reasonable dispatch in seeking rescission of the corporate transaction. Since the burden was put on the plaintiff, the defendant-corporation was not required to plead estoppel or waiver as an affirmative defense.

124. See note 48 *supra* and accompanying text. *But cf.* *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975) (court rejects argument that party is barred from seeking rescission of merger simply because he failed to seek injunction before merger was completed).

protecting the public interest in a healthy and stable economic environment. Prior to the recent *TSC Industries* case, many 14a-9 actions could be successfully maintained on a shareholder's showing that the defect in the proxy statement "might" have affected a reasonable shareholder's vote. This weak test of materiality must certainly have influenced the courts in the withholding of their discretionary equitable jurisdiction. Now that the test has been tightened-up, the courts should be more inclined to put teeth into the private enforcement of the proxy rules and allow more shareholders equitable relief once the burden of liability has been met.